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SUBJECT: Hang Seng Plummets, HKMA Cuts Base Rate but HIBOR Still Up

REFS: A) HONG KONG 1833, B) HONG KONG 1823

¶1. Summary: The Hang Seng Index followed the other Asian markets down sharply on Wednesday, falling 8.16 percent. The IMF's warning that losses from U.S. loans and securitized assets could reach US\$1.4 trillion appeared to drive investors to dump shares. In a presentation in Hong Kong, the IMF unveiled analysis that suggested the U.S. financial downturn would be "longer and larger" than expected, hitting bottom only in Q2 2009. The Hong Kong Monetary Authority announced it would cut its base interest rate by 100 basis points, beginning on Thursday. The HKMA's move couldn't stop HIBOR from rising 75 basis points for overnight lending and 45 basis points for three month loans. End Summary.

¶2. The Hang Seng Index plummeted on Wednesday, October 8, falling 1372.03 points to finish at 15431.73, down 8.16 percent, on volume of HKD 78 billion. Utility stocks, typically seen as a safe harbor for investors, led the market lower. Financial stocks also fell sharply. China Construction Bank dropped 12 percent on market rumors that Bank of America would sell its state when the lock-up period expires at the end of October. Bank of China (Hong Kong) and Bank of East Asia slipped 9 percent, ICBC was down 8 percent, Bank of China fell 6 percent, and HSBC and Hang Seng each slid 4 percent.

IMF Sees Larger, Longer Economic Downturn in 2009

¶3. In a presentation unveiling this year's World Economic Outlook, IMF Asia-Pacific Research head Roberto Cardarelli, explained the Fund's development of a Financial Stresses Index that identified periods of financial turmoil over the past 20 years. According to its model, only half of the periods of financial stress identified led to economic slowdowns. However, those periods of stress that were preceded by banking crises tended to result in economic downturns that were longer and larger than expected. The effects were particularly pronounced when household and corporate borrowing rates were high, real housing prices were up and credit was a higher percentage of GDP, said Cardarelli.

¶4. Cardarelli added that the Fund would release its Global Economic Forecast on Thursday, October 9. The Fund has revised its earlier prediction that the U.S. economy would reach the bottom by end 2008 and now expects the economy to continue contracting through the second quarter of 2009, he said. Those countries that rely on exports to the U.S. are likely to face mounting difficulties.

HKMA Reduces Base Rate, HIBOR Increases

¶5. The HKMA announced today that it would reduce its Base Rate, the reference rate for discount window borrowing, by 100 basis points, beginning Thursday, October 9. The rate has been set at 150 points above the U.S. Federal Funds Target Rate and is announced each day before the opening of the interbank market in Hong Kong. The new rate tomorrow will be 2.5 percent, down from 3.5 percent today. HKMA Chief Executive Joseph Yam noted that the Hong Kong rate has been higher than in other places. Given the stressful global

financial conditions a cut is now justified, he said.

16. The move did not help HIBOR in Hong Kong, which saw overnight rates jump from 1.75 percent on Monday (Tuesday was a holiday) to 2.5 percent. The benchmark three month rate also moved up, gaining 45 basis points to 4.25 percent. One week rates were 3.75 percent, one month was 4.7 percent, six months was 3.95 percent and one year rates were 3.75 percent.  
Donovan